An Opportunity to Readjust UK Tax Policy?

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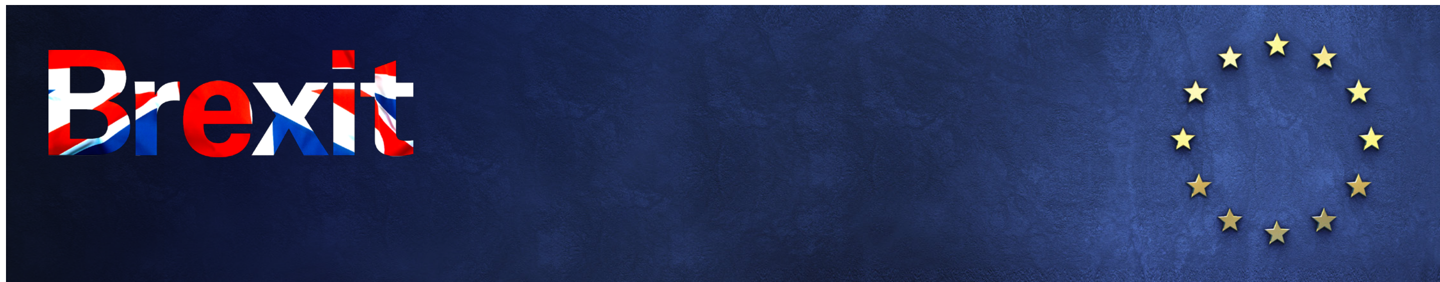

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The U.K. government mantra has for a number of years been: "Britain is open for business." This has been reflected in a number of areas relevant to U.K. domestic and foreign tax policy, including in a gradual reduction of the main rate of corporation tax — which stood at 30 percent in 2008, is currently 20 percent and is scheduled to decrease to 17 percent by April 2020 — and in radical reforms to certain other key areas of tax competitiveness, such as taxation of overseas profits.

Following the Brexit vote, the U.K. government has a vested interest in ensuring that the U.K. remains a prime jurisdiction for investment. Tax policy can play a meaningful part in doing so, but (as recognized by a recent Organisation for Economic Co-operation and Development (OECD) study) while low tax rates may continue to be a key part of a tax policy designed to achieve inclusive growth, they cannot get the job done alone. As the government contemplates navigating a path away from the European Union, multinational businesses with U.K. interests will need to understand which tax measures are unlikely to change, which might be revisited now and what could happen as far as U.K. corporate tax policy is concerned once the U.K. is no longer a member of the EU.

Unlikely to Change

The U.K. domestic measures implementing the conclusions of the base erosion and profit shifting (BEPS) reports, including anti-hybrid rules and interest deductibility limitations, are among the least likely to be revisited, as the U.K. has been a first mover and one of the main proponents of these measures within the BEPS process. Existing domestic anti-abuse and anti-avoidance regimes are equally unlikely to be meaningfully relaxed given the political and public opinion pressure to be seen as taking a hard line against perceived tax avoidance.

Considerations in the Shorter Term

Measures that could be revised in the shorter term include an acceleration in the proposed reduction in the corporation tax rate. It is not inconceivable that the rate could be cut beyond 17 percent: The previous U.K. chancellor of the exchequer, George Osborne, had suggested before his departure from office that it could be reduced to 15 percent. Reforms to the "non-dom" regime, which are due to take effect in April 2017, also might be revisited in order to retain some of the aspects that have historically helped attract a mobile workforce to the U.K. Reversing proposed changes to withholding taxes on payments of royalties and potentially increasing the scope of domestic exemptions from withholding on interest payments could encourage the flow of foreign investment into and through the U.K. In fact, following the recent European Court of Justice judgment in *Brisal*, the U.K. may be at a competitive disadvantage relative to other EU jurisdictions if "gross" withholding obligations are maintained.

Beyond the EU

A number of the recent, business-friendly changes to the U.K. tax framework have been driven by EU principles, including the broadening of the exemption from corporation taxes for dividends received, the reforms to rules governing U.K.-controlled foreign companies and the moratorium on the 1.5 percent charge on issuance of U.K. securities into certain clearing and depository systems. Rethinking these measures would be perceived as damaging U.K. tax competitiveness; as a result, the hope is that they will remain largely unchanged.

Once no longer part of the European Union, the U.K. would in principle not be bound to implement value-added tax rules in line with other member states. Rate changes and additional exemptions could be introduced and focused on U.K. priorities. The U.K. also would no longer be prohibited from providing "state aid," which means tax-based incentives specifically targeted at U.K. investment and growth could be considered. However, the U.K. would be limited by its international tax undertakings: As a member of the OECD and supporter of the BEPS reforms, the U.K. likely would not wish to be seen as going directly against the measures it has argued for throughout the BEPS process. Finally, the EU-promulgated Anti-Tax Avoidance Directive would not need to be implemented in the U.K., which is likely to be a comparative advantage for the U.K. going forward. That is because even though the U.K. is introducing some measures similar to those imposed by the directive, the U.K. will not be required to implement all of them, and it will be able to proceed on its own terms and change those terms unilaterally if it so chooses. EU member states do not have the same flexibility.

Conclusion

The Brexit vote has not caused the U.K. tax regime to become uncompetitive overnight. U.K. tax policymakers could build on a number of attractive features to further enhance the competitiveness of the tax regime and should be wary of taking steps that could prove to be uncompetitive and isolating. Advisers and businesses have a role to play as well — putting forward industry- and sector-specific suggestions for improvement, for instance. Those eager for a clear and certain expression of the direction of travel of U.K. tax policy will be closely watching the government's next moves.

This article was drafted in September 2016 and reflects the status of government announcements, law and case law at that time.